

General Information Letter: Application of sales factor rules to internet automobile advertising business.

July 20, 2005

Dear:

This is in response to your letter dated June 24, 2005 that was forwarded to me to address the income tax issues presented in your letter. It is my understanding that you will receive a letter under separate cover from our sales tax division regarding your questions relating to sales and use taxes. Your letter states the following:

A company (called Company ABC in this letter) located in Wisconsin will be conducting in your state one or more of the 5 transactions described below. In order to comply with your state's sales and use tax laws, it is important for Company ABC to be aware of your state's sales and use tax treatment of these transactions. Please answer the questions in this letter regarding the sales and use tax treatment of the 5 types of business transactions and the nexus questions.

I. Transaction A: Traditional Model

A. Facts:

1. Company ABC's employees visit dealers (i.e. customers) in your state and take photos of trucks and collect truck data on handheld computers. In some instances, it will take multiple photos and also move trucks to a location for taking the photos.
2. Company ABC exports the data and photos to any websites requested by the dealer.
3. Company ABC prints window labels and/or buyer's guides and applies them to the trucks if requested by the dealer.
4. Dealer has access to Company ABC's backend website (ABC.com) where the dealer can manage their inventory of trucks and internet leads (e.g. change prices of trucks, delete trucks, provide dealer one place to read and respond to inquiries, etc.).
5. Company ABC charges the dealer \$1000 per month for these services.

B. Questions:

1. Is the charge by Company ABC to the dealer in Fact 5 subject to your state's sales or use tax?
2. In Fact 3, are Company ABC's purchases of paper on which the window labels and buyers guides are printed, exempt from your state's sales and use tax?
3. If Company ABC's only transactions in your state are as described above for Transaction A, does Company ABC have nexus in your state for (1) sales and use taxes, and (2) income taxes?

II. Transaction B: For Sale by Owner:

A. Facts:

1. For \$30, an individual in your state can post a truck on Company ABC's website for the purpose of trying to sell the truck. The individual is responsible for furnishing a photo of the truck and other information about the truck to Company ABC.
2. Company ABC mails a kit of materials to the individual in your state. Company ABC's cost of the plastic bag for containing the materials and the paper on which the information is printed is purchased by Company ABC for \$1 to \$1.50. Mailing costs are about \$1.50.

B. Questions:

1. In Fact 1, is the \$30 paid to Company ABC subject to your state's sales or use tax? Would the answer be the same if the kit of materials in Fact 2 was not furnished to the individual?
2. In Fact 2, are Company ABC's purchases of the plastic bags and paper subject to your state's sales or use tax?
3. If Company ABC's only transactions in your state are as described above for Transaction B, does Company ABC have nexus in your state for (1) sales and use taxes, and (2) income taxes?

III. Transaction C: Do-it-Yourself (DIY):

A. Facts:

1. Company ABC charges dealers in your state \$500 per month per dealer location. If the dealer wants to use a handheld computer and camera of Company ABC, there is a charge of \$275 per month for these items, in which case the total charge would be \$775 per month.
2. Dealer gets access to ABC.com (website), inventory management, lead management, (e.g. all inquiries on the website go first to Company ABC who then directs them to the dealer for dealer to read and respond to inquiries, dealer can change prices, delete trucks, etc.), and the ability to print window labels and buyer's guides, which the dealer prints on its printer.
3. If dealer wants to purchase window labels or buyer guides from Company ABC, part of the labels and guides will be printed by Company ABC and mailed to the dealer. The dealer is billed an additional amount for these items. The dealer then prints the truck specifications on the label and buyers guides.

B. Questions:

1. In Fact 1, is the (1) \$500 payment, or (2) \$775 payment by the dealer to Company ABC subject to your state's sales or use tax?
2. In Fact 1, are Company ABC's purchases of the handheld computers and cameras subject to your state's sales or use tax? (Note: When Company ABC purchases these handheld computers and cameras, it first obtains possession of these items in Wisconsin and they are then shipped to the dealer in your state if they wish to use them for the charge of \$275 per month).

3. In Fact 3, is the charge by Company ABC to the dealer for the window labels and buyer guides subject to your state's sales or use tax?
4. If Company ABC's only transactions in your state are as described above for Transaction C, does Company ABC have nexus in your state for (1) sales and use taxes, and (2) income taxes?

IV. Transaction D: Reseller:

A. Facts:

1. XYZ in your state can access Company ABC's web site (which is private-labeled for XYZ).
2. XYZ provides dealers with access to their inventory. XYZ has access to all of his customers (i.e. dealers)
3. XYZ bills the dealers for the services it provides to them.
4. XYZ pays Company ABC \$300 per dealer per month. For example, if XYZ had 10 dealer customers, XYZ would pay Company ABC \$3,000 per month (10 x \$300).

B. Questions:

1. In Fact 4, is the payment by XYZ to Company ABC subject to your state's sales or use tax?
2. If Company ABC's only transactions in your state are as described above for Transaction D, does Company ABC have nexus in your state for (1) sales and use taxes, and (2) income taxes?

V. Transaction E: Reseller/Web/Equipment:

B. Facts:

1. Individuals (who are not employees of Company ABC) contact dealers in your state to sell the services of Company ABC.
2. Interested dealers will contact Company ABC regarding the services.
3. Company ABC offers two types of services: (1) access to Company ABC's website, (with no equipment furnished to the dealer), and (2) access to Company ABC's website and the use of Company ABC's handheld computer and camera.
4. For each dealer who purchases one of Company ABC's services as a result of the contact of the individual in Fact 1, Company ABC will pay the individual a fee.
5. A dealer who receives access to the website, with no use of Company ABC's handheld computer and camera, will be charged a fee by Company ABC.
6. A dealer who receives access to the website and the use of Company ABC's handheld computer and camera, will be charged a higher fee by Company ABC.

C. Questions:

1. In Fact 4, is the fee paid by Company ABC to the individual subject to your state's sales or use tax?
2. In Fact 5, is the amount paid by the dealer to Company ABC subject to your state's sales or use tax?
3. In Fact 6, is the all or part of the amount paid by the dealer to Company ABC subject to your state's sales or use tax? If only part is taxable, what part is taxable?
4. In Fact 6, are the purchases of the handheld computer and camera by Company ABC subject to your state's sales or use tax?
5. If Company ABC's only transactions in your state are as described above for Transaction E, does Company ABC have nexus in your state for (1) sales and use taxes, and (2) income taxes?

According to the Department of Revenue ("Department") regulations, the Department may issue only two types of letter rulings: Private Letter Rulings ("PLR") and General Information Letters ("GIL"). The regulations explaining these two types of rulings issued by the Department can be found in 2 Ill. Adm. Code §1200, or on the website <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

Due to the nature of your inquiry and the information presented in your letter, we are required to respond with a GIL. GILs are designed to provide background information on specific topics. GILs, however, are not binding on the Department.

Section 201 of the Illinois Income Tax Act ("IITA"), 35 ILCS 5/101 et seq, imposes a tax measured by net income on corporations for the privilege of earning or receiving income in this State. The Due Process and Commerce Clauses of the Federal Constitution limit the power of States to subject foreign corporations to tax. The Due Process Clause requires that there exist some minimum connection between a state and the person, property, or transaction it seeks to tax (Quill Corp. v. North Dakota, 504 U.S. 298, 112 S.Ct. 1904 (1992)). Similarly, the Commerce Clause requires that the tax be applied to an activity with a substantial nexus with the taxing state. Id.

The determination whether a taxpayer has nexus with Illinois for Illinois income tax purposes is highly fact-dependent. Therefore, the Department does not issue rulings regarding whether a taxpayer has nexus with the State. Such a determination can only be made in the context of an audit where a Department auditor has access to all relevant facts and circumstances.

It is generally beyond the scope of a letter ruling to give precise guidance on nexus issues. However, the facts recited in your request indicate that your client might not apportion any income to Illinois even if it does have nexus. Based on the information in your letter, IITA Section 304(a)(3)(C) is most applicable to your client's situation. This is because your client is selling web site advertising services that would be considered sales other than the sales of tangible personal property. Accordingly, a more pertinent question is whether your client has income producing activity in Illinois. Section 304(a)(3)(C) of the IITA states as follows:

- (C) Sales, other than sales governed by paragraphs (B) and (B-1), are in this State if:
 - (i) The income-producing activity is performed in this State; or

- (ii) The income-producing activity is performed both within and without this State and a greater proportion of the income-producing activity is performed within this State than without this State based on performance costs.

Income producing activity is further discussed in 86 Ill.Adm.Code Section 100.3370(c)(3):

3) Sales other than sales of tangible personal property in this State. The sales factor includes gross receipts from transactions other than sales of tangible personal property (including transactions with the United States Government); gross receipts are attributed to this State if the income producing activity which gave rise to the receipts is performed wholly within this State. Also, gross receipts are attributed to this State if, with respect to a particular item of income, the income producing activity is performed in this State, based on costs of performance.

A) Income producing activity defined. The term "income producing activity" applies to each separate item of income and means the transactions and activity directly engaged in by the person in the regular course of its trade or business for the ultimate purpose of obtaining gains or profit. Such activity does not include transactions and activities performed on behalf of a person, such as those conducted on its behalf by an independent contractor. The mere holding of intangible personal property is not, of itself, an income producing activity. Accordingly, the income producing activity includes but is not limited to the following:

- i) The rendering of personal services by employees or the utilization of tangible and intangible property by the person in performing a service.
- ii) The sale, rental, leasing, licensing or other use of real property.
- iii) The rental, leasing, licensing or other use of tangible personal property.
- iv) The sale, licensing or other use of intangible personal property.

B) Costs of performance defined. The term "costs of performance" means direct costs determined in a manner consistent with generally accepted accounting principles and in accordance with accepted conditions or practices in the trade or business of the person.

C) Application. Receipts (other than from sales of tangible personal property) in respect to a particular income producing activity are in this State if:

- i) the income producing activity is performed wholly within this State; or
- ii) the income producing activity is performed both in and outside this State and a greater proportion of the income producing activity is performed in this State than without this State, based on costs of performance.

D) Special Rules. The following are special rules for determining when receipts from the income producing activities described below are in this State.

- i) Gross receipts from the sale, lease, rental or licensing of real property are in this

- State if the real property is located in this State.
- ii) Gross receipts from the rental, lease, or licensing of tangible personal property are in this State if the property is located in this State. The principal cost of performance in a rental, leasing or licensing transaction is the depreciation or amortization of the tangible personal property, and the depreciation or amortization expense is incurred in the state in which the tangible personal property is located. The rental, lease, licensing or other use of tangible personal property in this State is a separate income producing activity from the rental, lease, licensing or other use of the same property while located in another state; consequently, if property is within and without this State during the rental, lease or licensing period, gross receipts attributable to this State shall be measured by the ratio which the time the property was physically present or was used in this State bears to the total time or use of the property everywhere during such period.

Example: Corporation X is the owner of 10 railroad cars. During the year, the total of the days each railroad car was present in this State was 50 days. The receipts attributable to the use of each of the railroad cars in this State are a separate item of income. Total receipts attributable to this State shall be determined as follows:

$$(10 \times 50)/3650 \times \text{Total Receipts}$$

- iii) Gross receipts for the performance of personal services are attributable to this State to the extent such services are performed partly within and partly without this State, the gross receipts for the performance of such services shall be attributable to this State only if a greater portion of the services were performed in this State, based on costs of performance. Where services are performed partly within and partly without this State and the services performed in each state constitute a separate income producing activity, the gross receipts for the performance of services attributable to this State shall be measured by the ratio which the time spent in performing such services in this State bears to the total time spent in performing such services everywhere. Time spent in performing services includes the amount of time expended in the performance of a contract or other obligation which gives rise to such gross receipts. Personal service not directly connected with the performance of the contract or other obligation, as for example, time expended in negotiating the contract, is excluded from the computations.

Example: Corporation X, a road show, gave theatrical performances at various locations in State X and in this State during the tax period. All gross receipts from performances given in this State are attributed to this State.

Example: A public opinion survey corporation conducted a poll by its employees in State X and in this State for the sum of \$9,000. The project required 600 man hours to obtain the basic data and prepare the survey report. Two hundred of the 600 man hours were expended in this State. The receipts attributable to this State are \$3,000, calculated as follows:

$$200/600 \times \$9,000$$

Your letter does not provide sufficient information to make a determination whether your client has enough Illinois income-producing activities to subject it to Illinois income taxes.

All of your income tax related questions deal with the issue of nexus. Although the facts presented in your letter lead me to believe that the more appropriate issue is whether your client has income producing activity in Illinois, enclosed for your convenience is a copy of the Illinois regulation discussing nexus: 86 Ill.Admin.Code 100.9720.

As stated above, this is a general information letter which does not constitute a statement of policy that either applies, interprets or prescribes tax law. It is not binding on the Department. Should you have additional questions, please do not hesitate to contact our office.

Sincerely,

Heidi Scott
Staff Attorney -- Income Tax